

Message Text

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47

ACTION EA-10

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R 160855Z OCT 74

FM AMEMBASSY JAKARTA

TO SECSTATE WASHDC 4896

INFO AMEMBASSY THE HAGUE

AMCONGEN HONG KONG

AMEMBASSY KUALA LUMPUR

AMEMBASSY MANILA

AMEMBASSY SINGAPORE

AMEMBASSY TOKYO

AMCONSUL MEDAN

AMCONSUL SURABAYA

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TAGS: EFIN, EGEN, ID

SUBJ: GOI ACHIEVES TENUOUS TRUCE IN BATTLE WITH INFLATION

1. SUMMARY: RANKING HIGH IN 1973 AMONG MORE RAPIDLY
INFLATING ECONOMIES, INDONESIA IN SIX MONTHS SINCE
APRIL 1974 HAS REGAINED FAIR CONTROL OF PRICES, INCREASES
NOW RUN AT NIMBLE BUT MORE TOLERABLE ANNUAL LEVEL OF
16-20 PERCENT. CONTROL REMAINS TENUOUS HOWEVER AS CREDIT
EXPANSION PROCEEDS AT RISKY RATE. END SUMMARY.

2. INDONESIA IN FY 1973 GAINED DUBIOUS DISTINCTION
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AS ONE OF WORLD'S MORE RAPIDLY INFLATING

ECONOMIES,
WITH PRICE INCREMENTS APPROACHING 50 PERCENT ANNUALLY (UP TO 100 PERCENT FOR NON-RICE PRICES). UNCONTROLLED CREDIT EXPANSION COMBINED WITH BALLOONING IMPORT AND EXPORT PRICES TO BECOME MAIN CONTRIBUTORS. IN APRIL 1974 GOI DECREED ANTI-INFLATION PACKAGE OF CREDIT EXPANSION CEILINGS AND HIGH INTEREST ON SAVINGS UP TO 30 PERCENT PER ANNUM. THESE IT COMBINED WITH TIGHT BUDGET MANAGEMENT IN EFFORT TO CONTROL INFLATION -- A CONTRIBUTORY FACTOR IN POPULAR DISCONTENT EXPRESSED IN JANUARY 1974, RIOTS.

3. AFTER SIX MONTHS' EXPERIENCE UNDER NEW POLICIES, GOI EFFORT RATES AS MODERATE SUCCESS -- WITH RESERVATIONS. OVERALL EFFECTS HIGHLY BENEFICIAL, WITH PRICES OF RICE AND OTHER BASIC ESSENTIALS MOST AFFECTING POPULAR CONSUMPTION (MAINLY ADMINISTERED-PRICE COMMODITIES) ACTUALLY 7 PERCENT BELOW END-MARCH 1974. TRADITIONAL UP-SURGE OF PRICES AS END OF RAMADAN (LEBARAN) APPROACHES HAS BEEN NOTABLY LACKING. JAKARTA 65-ITEM INDEX SHOWS SIX-MONTH INCREASE AT ANNUAL RATE OF 16 PERCENT--WELL BELOW GOVERNMENT GOAL OF 25 PERCENT FOR FY 1974/75, AND HALF OF RATE FOR SAME PERIOD LAST YEAR. (UNPUBLISHED 100-ITEM INDEX SHOWS SOMEWHAT HIGHER INCREASE - NEARER 20 PERCENT, MAINLY BECAUSE NEWER INDEX GIVEN LOWER WEIGHT TO RICE, PRICE OF WHICH DECLINED OVER SIX-MONTH PERIOD.)

4. COMPONENTS OF ANTI-INFLATION PACKAGE HOWEVER CONTRIBUTED IN DIFFERING DEGREES TO FAVORABLE RESULT. CREDIT EXPANSION, DESPITE IMPOSITION OF 20-25 PERCENT CEILING FOR FY 1974/75, PROCEEDED AT RISKY 33 PERCENT CLIP. ALSO, RAPID ACCUMULATIONS OF FOREIGN EXCHANGE BUILT UP MASSIVE POTENTIAL FOR FURTHER MONEY SUPPLY EXPANSION. OFFSETTING FAVORABLE FACTORS WERE THAT GOVERNMENT CONTINUED EXPANDING ITS BUDGETARY SURPLUS RAPIDLY ENOUGH TO OFFSET ROUGHLY 80 PERCENT OF FOREIGN EXCHANGE ACCUMULATIONS. INCREASED INTEREST RATES PAID ON SAVINGS PRODUCED FURTHER OFFSET VIA EXPANSION OF PRIVATE SAVINGS IN BANKS AT ANNUAL RATE OF 67 PERCENT, NEARLY TRIPLE THAT FOR SAME PERIOD LAST YEAR. AS NET RESULT ALL THESE FACTORS, MONEY SUPPLY (M.S.) NOW EXPANDING AT BRISK BUT ACCEPTABLE ANNUAL RATE (22 PERCENT). (TYPICALLY INDONESIA UNCLASSIFIED

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SINCE 1970 HAS ABSORBED OVER 25 PERCENT MS EXPANSION WITHOUT SIGNIFICANT INFLATION.)

5. GOVERNMENT ALSO SHOWS NOTABLE VIGOR IN BUILDING UP STOCKS AND PIPELINE OF ESSENTIAL COMMODITIES TO PROTECT AGAINST FUTURE SHORTAGE-CREATED PRICE INCREASES. FINALLY, EXTERNAL FACTORS MARGINALLY FAVORED SUCCESS GOI ANTI-INFLATION EFFORT AS PRICES OF KEY CONSUMER IMPORTS

(WHICH NEARLY DOUBLED BETWEEN SEPTEMBER 73 AND APRIL 74)
AND OF TRADITIONAL EXPORTS GENERALLY STOPPED RISING AND ON
AVERAGE IMPORTS APPEAR 10 PERCENT AND EXPORTS 25 PERCENT BELOW
PEAK LEVELS OF EARLY 1974.

6. MODERATION OF INFLATION NOT WITHOUT MODEST COSTS TO
ECONOMY AS SOME BUSINESSMEN IN SOME SECTORS COMPLAIN OVER
CREDIT "SHORTAGES" (READ "DOUBLED PRICES OF RAW MATERIALS
AND CAPITAL GOODS"). VAST MAJORITY OF POPULATION GAINED
RELIEF FROM ANTI-INFLATION EFFORT, ALTHOUGH PRICE LEVELS
OF NINE ESSENTIAL COMMODITIES IN MEDA, PALEMBANG, MENADO
AND MORE REMOTE AREAS OUTSIDE JAVA REMAIN 25, 40 AND EVEN
60 PERCENT HIGHER THAN IN JAKARTA. NO INDICATIONS YET OF
CREDIT RESTRAINTS CAUSING RECESSION IN DOMESTIC BUSINESS
ACTIVITY, BUT SOFTENING DEMAND ABROAD IS HURTING TRADITIONAL
EXPORTS AND PRODUCING INFLUX OF JAPANESE/HONG KONG TEXTILE
WHICH AT LEAST TEMPORARILY HURTING DOMESTIC MILL SALES.

7. PROSPECTS FOR CONTAINING INFLATION BELOW 25 PERCENT FOR
SECOND HALF 1974/75 APPEAR GENERALLY FAVORABLE BUT STILL
SOMEWHAT TENUOUS. HIGH RATE OF CREDIT EXPANSION
REMAINS WORRISOME. TO ENFORCE FY CREDIT CEILING
GOVERNMENT MUST HOLD SECOND-HALF EXPANSION TO ANNUAL RATE
BELOW 17 PERCENT -- A SEVERE LIMIT RELATIVE TO NORMAL
RATE OF EXPANSION. INFLATIONARY POTENTIAL OF LARGER-
THAN-EVER FOREIGN EXCHANGE RECEIPTS FROM OIL COMPANY
TAX PAYMENTS IN OCTOBER AND MARCH WILL CONTRIBUTE
DANGEROUS INFLATIONARY POTENTIAL UNLESS CREDIT CONTROLS
HOLD AND GOVERNMENT RESISTS PRESSURES FOR GREATER
DOMESTIC BUDGET EXPENDITURES. OVERALL HOWEVER, ODDS
FAVOR GOVERNMENT SUCCESS.

8. IN ANY EVENT, INDONESIA ENJOYS LUXURY OF KNOWING
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THAT RUPIAH REMAINS ONE OF WORLD'S STRONGER LDC
CURRENCIES SO LONG AS OIL EXPORT PRICES REMAIN HIGH
(REFTEL).
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